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RUEHTN/AMCONSUL CAPE TOWN 5509
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SIPDIS

DEPT FOR AF/S/MTABLER-STONE; AF/EPS; EB/IFD/OMA
USDOC FOR 4510/ITA/MAC/AME/OA/DIEMOND
TREASURY FOR TRINA RAND
USTR FOR COLEMAN

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SUBJECT: SOUTH AFRICA ECONOMIC NEWS WEEKLY NEWSLETTER APRIL 11, 2008
ISSUE

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11. (U) Summary. This is Volume 8, issue 15 of U.S. Embassy Pretoria's South Africa Economic News Weekly Newsletter.

Topics of this week's newsletter are:

- Reserve Bank Lifts Repo Rate
 - Surprise Surge in Factory Output
 - Eskom Defends Hikes as Predictions Were Off
 - Even State Housing Projects Can't Plug In
 - DEAT Rejects Titanium Mining Proposal
 - Oops! Ugandan Minister Publicly Criticizes SAG Telecom Policies
 - Telkom Flounders over Business Strategy
 - Oger to Renew Telkom Bid
 - Neotel Brings Competition to Telkom
- End Summary.

Reserve Bank Lifts Repo Rate

12. (U) The South African Reserve Bank (SARB) raised its policy interest rate (repo rate) by 50-basis-points to 11.5% on April 10, after inflation surged to a five-year high and moved further away from the 3-6% target range. The half-percentage-point rise resumes a monetary tightening cycle that paused in January on concerns over economic growth, and brings the total rate hikes to 450 basis-points since June 2006. While consumer spending has cooled, inflation continues to beat expectations, with the targeted CPIX inflation (CPI less mortgage interest) hitting 9.4% y/y in February, the 11th month it has exceeded the target band. (Business Day, April 10, 2008)

Surprise Surge in Factory Output

13. (U) Statistics South Africa (StatsSA) reported that manufacturing output increased from 1.2% y/y in January to 3.5% y/y in February. The increase surprised markets. Power outages and waning consumer demand had fanned fear of a fall in output in the manufacturing sector, which accounts for more than 16% of the economy. "Barring a collapse in March, output in the sector will probably be less of a drag on first-quarter growth than we anticipated," said Citigroup Economist Jean Francois Mercier. Mining and manufacturing are seen to have been hit hardest by Eskom's power shortages. Gains were

most pronounced in value-added sectors such as vehicles and parts, which rose 6% in February, electrical machinery, which rose 16.7%, and household appliances, up 9.9%. Analysts said resilience in manufacturing output stemmed from the depreciation in the rand, more than 12% weaker against the dollar and 16% weaker on a trade-weighted basis this year. "Weakness in the rand from the beginning of 2008 is inflating the value of manufacturing sales and supports manufacturing exports, which in turn should provide momentum to production," Efficient Research Economist Fanie Joubert said. However, the outlook for the sector this year is still poor, in the face of a global slowdown, waning consumer demand, and continued power rationing. (Business Day, April 10, 2008)

Eskom Defends Hikes as Predictions Were Off

14. (U) Eskom has justified its request for a 53% real increase in its electricity tariffs (also referred to as 60% nominal increase) by stating that the price is too low and consumers should carry the costs of fuel and coal price hikes. Eskom CEO Jacob Maroga said Qcosts of fuel and coal price hikes. Eskom CEO Jacob Maroga said Eskom could not accurately predict coal prices, particularly spot coal, over a multi-year pricing model. Maroga said there were three main drivers for the price increase: the short-term contracts for coal supply, which include increasing transport costs; the rising cost of diesel, which is used in some turbines; and Eskom's attempts to fast-track certain projects on the demand side that would cost more money. Coal stock levels were hampered recently by rains and a strike. Contracts have now been secured for 39 million tons of additional coal over the next two years. Maroga said, "load-shedding is not our preferred option. It pains us to do so, and we know it causes consumers a lot of stress. It can be avoided if customers reduce their consumption." Electricity regulator NERSA gave Eskom permission to have "commercially sensitive" information on its tariff increase withheld from publication. The entire application was to be posted on the NERSA web-site for public comment. NERSA recently asserted that if Eskom achieved its requested increase, the state power supplier would earn a whopping

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after-tax profit of over \$1.5 billion. (Pretoria News, Engineering News, April 3-8, 2008)

Even State Housing Projects Can't Plug In

15. (U) Two low-cost National Housing Finance Corporation (NHFC) housing projects involving 834 housing units and a total investment of \$13 million are at risk because of Eskom's new policy on new developments. A NHFC spokesperson confirmed that these projects would be at risk if Eskom did not provide electricity to new low-cost housing projects, even though this project already has approved loans. Eskom said last month it would take up to six months to give a quote on new applications for projects requiring more than 100 kilovolt amperes of electricity. Eskom confirmed its recent rejection of an application for bulk electricity supply to a public-private partnership for a mixed housing development that would provide 9,315 residential units. The construction industry has been particularly critical of this policy. (Business Report, April 2, 2008)

DEAT Rejects Titanium Mining Proposal

16. (U) The Department of Environmental Affairs and Tourism (DEAT) rejected Australia-based Mineral Commodities' (MRC) proposal to mine titanium in the Xolobeni dunes of Port Edward south of Durban. Exploratory drilling revealed that the dunes contain the tenth-largest titanium deposits in the world, which could be worth over R10 billion (\$1.3 billion). MRC argued that the operation could help eradicate poverty by developing the area and creating job opportunities with minimal environmental impact. DEAT rejected MRC's environmental impact assessment report and cited deficiencies in several areas. According to DEAT, the MRC report does not address dune rehabilitation or waste storage and treatment issues. The dunes lie next to nature reserves on the border of the Kwa-Zulu Natal and the Eastern Cape Provinces, which are slated for ecotourism development. A DEAT report classified the area as one

of the highest conservation priority areas. A Department of Minerals and Energy official lamented that a compromise, "win-win" situation could only be achieved if DEAT was not trying to declare the entire coastline off limits for mining. Meanwhile, an amendment in the National Environmental Management Act to make DEAT the final appeals authority on mining EIA is well underway. (Financial Mail, April 11, 2008)

Oops! Ugandan Minister Publicly Criticizes SAG Telecom Policies

17. (U) Uganda's Minister for Information and Communications Technologies Alintuma Nsambu chided the SAG for meddling too much in the telecom sector, saying a lighter touch would grow the industry, cut the cost of services and help local companies to flourish. Nsambu was sharing a stage with SA Science and Technology Minister Mosibudi Mangena at the Satcom Africa conference in Johannesburg, when he suggested that SA should rethink its telecoms regulations. Later he apologized for making his criticisms in public instead of QLater he apologized for making his criticisms in public instead of discussing them in private. Mangena said the reproaches should be directed at SA's Department of Communications and Department of Trade and Industry instead. According to Nsambu, the government's role should be to support private companies by removing any bottlenecks, such as ensuring that officials did not need bribing to get things done or to allow equipment to clear customs. "Liberalizing the telecom sector means discouraging monopolies or duopolies," he said in a dig at SA, where Neotel was belatedly granted the sole license that opened up competition to Telkom. Then he took another jab, saying the private sector should be left to build and operate under-sea telecommunications cables. SAG is already championing its involvement in at least two under-sea cable projects, and is jeopardizing plans to increase Africa's bandwidth by insisting that private cables may land in SA only if they are majority African-owned. Nsambu attacked the high cost of Internet access in SA, even though the country is not reliant on expensive satellite connections. "Ironically, in SA the cost of internet usage isn't cheap," he said. Much of SA's international traffic is carried on the undersea cable with prices that Telkom has kept artificially high. Nsambu said full liberalization of the telecoms sector was extremely important for any nation's economy. Mangena denied that progress in SA was shackled by the SAG's regulation of undersea cables or by creating Infracore as a state-owned supplier of

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broadband infrastructure. Some areas could be liberalized further, but the regulatory environment laid the ground rules rather than inhibited progress, Mangena said.

Telkom Flounders over Business Strategy

18. (U) After playing up its plans to become a significant force in the pay-TV industry, fixed-line operator Telkom has changed direction and is leaving the sector. CEO Reuben September surprised analysts when he outlined plans to reduce Telkom's shareholding in Telkom Media from 66% to what he describes as "the smallest possible stake". At the same time, Telkom has announced plans to take the fight to the cellular operators, including associate Vodacom, in which it holds a 50% stake, by building its own mobile network. The plan illustrated the untenable nature of the company's stake in Vodacom. Both Vodacom and MTN are building national fixed-line networks that will enable them to compete aggressively with Telkom. The latest developments have some analysts wondering whether Telkom has a coherent strategy. In pay-TV, it is clear that management has had a change of heart. The company now says there are other projects that will deliver a better return more quickly. These include offshore expansion and investment in new wireless networks. September obfuscated when asked whether Telkom was open to selling its stake in Vodacom without an alternative mobile investment lined up. Domestically, Telkom planned to invest in a fixed-wireless network and in a mobile data network that will compete with the MTN and Vodacom offerings. However, Telkom could still find itself the prey of a larger operator. It has already rejected a non-binding offer from Oger Telecom of Dubai, but September said the company has "no emotional hang-ups" about selling part or all of the business if the right offer is tabled.

Oger to Renew Telkom Bid

¶9. (U) CEO Paul Doany said Oger Telecom of Dubai will renew its offer for Telkom. Telkom said it would not consider the sale without a "strategic rationale" and rejected Oger's undisclosed proposal on grounds that it was not in the shareholders' interest. But Doany, also chairman of land-line operator Turk Telekom, told Reuters that Oger planned a fresh offer that will benefit all stakeholders. Oger, controlled by the family of late Lebanese Prime Minister Rafik Hariri, also operates in Saudi Arabia, Lebanon, and Jordan. Doany said Oger's Telkom offer, which was for a substantial minority stake with management control, would aim at merging Oger's South African mobile subsidiary Cell C (the number three mobile operator after Vodacom and MTN) with Telkom's fixed-business. Doany dismissed Telkom's concerns that Oger's offer did not have a strategic rationale. Doany said Oger wanted to create a structure in South Africa similar to Turkey, where it has a controlling 55% stake in Turk Telekom and 81% in Avea (Turkey's third-largest mobile operator). "We are producing good results in Turkey and we want to have the same in South Africa because the two markets resemble each other in many ways," he said. "We fully support the expansion plans of Telkom in the African continent, with South Africa being a natural for such expansion, focusing on segments hitherto neglected by other operators." (Engineering News, April 3, 2008)

Neotel Brings Competition to Telkom

¶10. (U) Neotel clocked up R1 billion (\$128 million) in business in its first year of operation and is expected to win deals worth R2 billion (\$256 million) in fiscal year 2008. However, profits are still a long way off as capital expenditures of R1.5 billion (\$192 million) will soak up revenue as it rolls out more wireless and fiber-optic network facilities. Neotel's plans include a R11 billion investment over the next ten years. CEO Ajay Pandey said its cash flow should turn positive after three years. "Out of the top 350 customers, we have made inroads into almost 120 and we are beginning to get repeat orders." So far, most companies have given Neotel only about 5% of their telecoms spending, but a handful now give it at least 25% of their voice and data contracts. From the end of April, consumers in certain areas would be able to sign up for a Neotel line instead of a Telkom line. Neotel will also offer handsets capable of handling video calls and accessing the internet. Telkom announced plans to bulk up its own voice and data carrying capacity, largely by installing more wireless technologies. Pandey said that was a smart move, as global studies showed that operators benefited most from market liberalization if they expanded and sold

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spare capacity to rival players. Refusing to let rivals access their infrastructure might appear to be a strategic advantage, but operators that had kept their network facilities solely for their own use were far less successful than those that capitalized on the growing demand as more rivals entered the market, Pandey said. Pandey said he would be happy to lease some of Telkom's infrastructure, but its high prices meant it was more cost effective for Neotel to build its own. (Business Day, April 4, 2008)

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